

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Executive Representative
Investment Banking
Legal & Compliance
Operations
Research
Senior Management

KEY TOPICS

Advertising
Investment Banking
Research Reports

GUIDANCE

Research Analysts and Research Reports

NASD and NYSE Provide Further Guidance on Rules Governing Research Analysts' Conflicts of Interest

Executive Summary

In July 2002, NASD and the New York Stock Exchange (together, the SROs) issued a joint memorandum (the July 2002 Joint Memo) that provides interpretive guidance on NASD Rule 2711 (Research Analysts and Research Reports) and the research analyst provisions of NYSE Rules 351 and 472.¹ Since that time, the SROs have amended their rules governing research analysts and research reports,² and members have raised additional questions regarding these rules.

Accordingly, the SROs are issuing a second joint memorandum that provides further interpretive guidance to the research conflict of interest rules. Attachment A is the new joint memorandum. Attachment B is the current version of Rule 2711 for reference. Unless otherwise noted in the new joint memorandum, the guidance included in the July 2002 Joint Memo continues to apply.

Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Joseph P. Savage, Counsel, Investment Companies Regulation, Regulatory Policy and Oversight (RPO), at (240) 386-4623; or Philip Shaikun, Associate General Counsel, RPO, at (202) 728-8451.

Endnotes

¹ See *Notice to Members 02-39* (July 2002).

² See *Notice to Members 03-44* (July 2003).

ATTACHMENT A

JOINT MEMORANDUM OF NASD AND THE NEW YORK STOCK EXCHANGE

Discussion and Interpretation of Rules Governing Research Analysts and Research Reports (NASD Rule 2711 and NYSE Rules 351 and 472)

Background

This is a follow up to the joint memorandum issued by NASD and the New York Stock Exchange (the "SROs")¹ in July of 2002 (the "July 2002 Joint Memo") that provided interpretive guidance on NASD Rule 2711 ("Research Analysts and Research Reports") and amendments to NYSE Rule 472 ("Communications with the Public") and Rule 351 ("Reporting Requirements") (collectively, the "SRO Rules").²

In July 2003, the Securities and Exchange Commission ("SEC") approved further changes to the SRO Rules that imposed new requirements on members³ and made other changes necessary to comply with research analyst provisions of the Sarbanes-Oxley Act of 2002 (the "July 2003 Amendments").⁴ This joint memorandum serves two purposes. First, the memorandum provides further clarification of previously issued interpretive guidance in light of the July 2003 Amendments. Second, it provides further interpretive guidance on the SRO Rules and responds to common questions that members have asked since the July 2002 Joint Memo was issued.

Continued Applicability of July 2002 Joint Memo

Members have inquired whether the guidance provided in the July 2002 Joint Memo continues to apply given the July 2003 Amendments. Unless otherwise noted below in this memorandum, the guidance in the July 2002 Joint Memo continues to reflect the SROs' interpretations of the SRO Rules. This memorandum is organized by subject matter and any change to the previous guidance in the July 2002 Joint Memo is noted in the applicable section.

Applicability of Registration and Continuing Education Requirements to Fixed Income Research Analysts

Members have inquired whether the new registration and continuing education requirements for research analysts⁵ apply to research analysts that only produce research on fixed income securities. As a general matter, the research analyst registration requirements and continuing education requirements apply only to analysts that are the subject to the SRO Rules. That is, these requirements apply only to associated persons that are primarily responsible for the preparation of the substance of a research report on equity securities or whose name appears on such a research report. The requirements do not apply to research analysts that only produce research reports on fixed income securities that are not “equity securities” as defined in Section 3(a)(11) of the Securities Exchange Act of 1934.

Definition of “Research Report”

As of September 29, 2003, the term “research report” is defined as “a written or electronic communication that includes an analysis of equity securities or individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.”⁶ Previously, the definition also required that the communication include a recommendation. That requirement was deleted in order to conform the SRO Rules to the definition of “research report” in the Sarbanes-Oxley Act.

While the SRO Rules no longer require that a research report contain a recommendation as a determining criteria, the analysis described in the July 2002 Joint Memo generally still applies. Although the issue of whether a communication is a research report still is determined by the individual facts and circumstances surrounding a particular communication, the list of exceptions in the July 2002 Joint Memo that are not generally “research reports” still applies under the new definition. Members should be aware that a disclaimer inserted into a communication with the public that indicates that the communication does not contain information sufficient upon which to base an investment decision has no relevance as to whether the communication falls within the definition of research report and could be misleading in certain circumstances.

Members have inquired whether a client communication that analyzes or recommends individual stocks would be considered a “research report” if it is written by an employee, such as a registered representative, who does not hold the title of “research analyst” and does not work in the member’s research department. To clarify this issue, the SROs are adopting the interpretation issued by the SEC with respect to Regulation AC: a client communication that analyzes individual securities or companies will be considered a research report if it provides information reasonably sufficient upon which to base an investment decision and is distributed to at least 15 persons. This conclusion applies even if the author of the communication does not hold the title of “research analyst” and does not work in the member’s research department.

The SROs also are adopting the SEC interpretation regarding periodic reports and other communications prepared for investment company shareholders or discretionary investment account clients.⁷ Communications that discuss individual securities in the context of a fund’s or account’s past performance or the basis for previously made discretionary investment decisions (such as a manager’s discussion of fund performance in a mutual fund shareholder report) are generally excluded from the definition of “research report.”

Likewise, an investment company portfolio manager that prepares these types of communications would not be considered a “research analyst” for purposes of the SRO Rules even if he or she were registered with a member. However, if such a portfolio manager prepares communications that meet the definition of “research report” and do not fall within the exception noted above, those communications will be subject to the SRO Rules and the portfolio manager will be regarded as a research analyst.

Quantitative and Technical Research Reports

The SROs have continued to receive inquiries as to whether quantitative or technical research reports fall within the definition of “research report” under the SRO Rules. The July 2002 Joint Memo excluded from the definition of “research report” communications of “technical analysis concerning the demand and supply for a sector, index or industry based on trading volume and price.” The SROs do not believe it is consistent with the purposes of the SRO Rules to exclude technical analysis of individual securities. Such an interpretation could allow a research analyst to provide coverage of a security of an issuer with which the member has an investment banking relationship or where the analyst may have a personal financial interest without the disclosures that would identify such potential conflicts. These are some of the very conflicts the

SRO Rules are intended to address. The SEC similarly excluded from the definition of “research report” in Regulation AC only sector, index and industry technical analysis.

The SROs believe the term “quantitative” as applied to research can be subject to various interpretations. Indeed, many research reports typically labeled “quantitative” by members can and do raise conflicts concerns. In this regard, not all mathematical models are inherently objective. Many such models are based on subjective formulas where a person or persons selects or can change the inputs: for example, particular performance ratios or consensus earnings estimates. The SROs are concerned that such models based on subjective formulas could be manipulated to produce a desired result, depending on the ratios or other criteria selected, the universe of securities, and the formula employed.

Consequently, the SROs do not believe it appropriate to categorically exclude any “quantitative” research from the scope of the SRO Rules. Nonetheless, the SROs do recognize that certain “quantitative models” devised by members may sufficiently guard against any potential conflicts of interest to render them outside the definition of a “research report.” Thus, reports generated by formulas that are generally free of subjective inputs from an employee of a member may fall outside the definition of research report. However, the SROs believe that such a determination is best considered on a case-by-case basis.

Definition of “Public Appearance”

The SRO Rules define the term “public appearance” as “any participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public speaking activity in which a research analyst makes a recommendation or offers an opinion concerning an equity security.”⁸ Members have inquired whether password-protected conference calls or web casts in which a research analyst provides his or her opinion on individual companies or securities constitute public appearances for purposes of the SRO Rules.

As discussed above, and consistent with SEC Regulation AC, an analysis of individual securities or companies prepared for a specific person or a limited group of fewer than 15 persons is not considered to be a “research report.”⁹ The SROs believe that a similar standard is appropriate to apply to public appearances. Thus, an appearance before persons representing 15 or more separate investors will be regarded as a public appearance for purposes of the SRO Rules. However, the SROs would not require an analyst to make the disclosures required for public appearances in a password protected web-cast, conference call or similar event with more than 15 existing customers (e.g. individuals or entities), provided (1) all of the call participants

previously received the most current research report or other documentation that included the required disclosures and (2) the research analyst making the public appearance corrects and updates any disclosures in the research report that are inaccurate, misleading or are no longer applicable. If representatives of the media attend the public appearance, the analyst must make the required disclosures. Members also are reminded that such appearances are subject to appropriate record keeping requirements, which in this case must include a record of all attendees at the public appearance.

Application of SRO Rules to Third-Party Research

The July 2002 Joint Memo included guidance on the applicability of the SRO Rules to third-party research distributed by a member. That memo states that if a member distributes research produced by a non-member affiliate, such as a foreign broker/dealer or an investment adviser, or an independent third party (other than through a soft dollar arrangement), it must accompany this research with the following "Third-Party Research Disclosures," if applicable:

- ▶ the member's and its affiliates' ownership of the subject company's securities;¹⁰
- ▶ that the member or its affiliates managed or co-managed a public offering of the subject company's securities in the past 12 months, received compensation for investment banking services from the subject company in the past 12 months, or expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;¹¹
- ▶ that the member was making a market in the subject company's securities at the time the research report was published;¹² and
- ▶ any other actual, material conflict of interest of the member known at the time of distribution of the research report.¹³

Absent a soft dollar arrangement, when a member distributes another member's research report, the distributing member must include the Third-Party Research Disclosures, while the member that prepared the report must comply with all of the disclosures required by the SRO Rules.

This memorandum addresses three questions that have arisen with respect to third-party research. (1) Are any of the new disclosures required by the recently amended SRO Rules now included in the required Third-Party Research Disclosures? (2) What factors determine whether a

research report is considered to be the product of the member rather than its affiliate or an independent third party? (3) Do different rules apply to the distribution of non-member affiliate research and independent third-party research?

Disclosure of Non-Investment Banking Compensation

The July 2003 Amendments to the SRO Rules require a member to provide additional disclosure in research reports regarding compensation that it or its affiliates receive from the subject company. The SRO Rules now require a member to disclose if it received compensation for products or services other than investment banking. This information must be current as of the end of the month preceding the date of publication of the research report (or the end of the second most recent month if the publication date is less than 30 calendar days after the end of the most recent month). A member also must disclose if the analyst or an employee with ability to influence the substance of the research report has actual knowledge as of the date of publication that the member received such compensation.

In addition, the July 2003 Amendments also generally require the disclosure in research reports of receipt of non-investment banking compensation received by a member's *affiliates*. However, a member is not required to disclose the receipt of non-investment banking compensation by its affiliates if the member has implemented procedures prescribed by NASD Rule 2711(h)(2)(v)(b) and NYSE Rule 472(k)(1)(iii)a.2. Under these provisions, a member is not required to disclose an affiliate's non-investment banking compensation from a subject company if the member maintains and enforces policies and procedures to wall off research analysts and employees with ability to influence the substance of research reports from receiving information about such compensation.

Finally, a member must disclose if the subject company is or has been during the preceding 12-month period a client of the member. In such cases, the member also must disclose the types of services provided to the subject company, categorized as either investment banking services, non-investment banking securities-related services, or non-securities services.

The SROs will not require a member that distributes third-party research to separately disclose non-investment banking compensation received by the member or an affiliate, unless receipt of that compensation represents an actual, material conflict of interest of the member known at the time of the distribution of the research report. Similarly, a member need not disclose the existence of a client relationship with the subject company, unless such relationship already falls within the current Third-Party Research Disclosures, such as managing or co-managing a public

offering of the subject company within the previous 12 months. In sum, members are required to make the same disclosures under the SRO Rules when distributing third-party research as they were required to make prior to the July 2003 Amendments, recognizing that the receipt of non-investment banking compensation can, under certain circumstances, represent a material conflict of interest.

Member vs. Third-Party Research Report

The determination of whether a research report is considered a product of the member or of a third party depends on: (1) whether the report appears to be the product of a member or (2) whether a “research analyst” (as defined by the SRO Rules) associated with a member is involved in producing the research report. It is irrelevant to the analysis where a report is distributed — domestically or internationally — or to whom it is distributed, or on which market the subject company’s securities are traded.

The SROs consider research reports that meet either of these above factors to be reports produced by the member that must meet all of the SRO Rules’ requirements. Thus, for example, if a member issues a “globally-branded”¹⁴ research report, all of the SRO Rules would apply to that report. Similarly, if a member adapts, alters or distributes a research report produced by an affiliate or an independent third party in such a way that an investor reasonably could believe it to be the product of the member, rather than that of the affiliate or independent third party, then the report will be considered to be the member’s own and subject to all of the SRO Rules. A research report prepared by a “mixed research team” that includes at least one person who meets the definition of “research analyst” and is associated with the member also would be considered a report produced by the member.

Independent and Non-Member Affiliate Research Reports

A research report distributed by a member that is produced either by an independent third party or non-member affiliate must include the Third-Party Research Disclosures. In this regard, the interpretations of the SRO Rules treat independent third-party research and non-member affiliate research the same, with one exception. A member that makes a non-member affiliate’s research report available to its customers upon request or through its website or a website maintained by the member must include the Third-Party Research Disclosures. However, these disclosures do not apply to independent third-party research that is similarly made available to customers upon request or through a member-maintained website.

Subject Company Review of Research

The SRO Rules require legal or compliance personnel (the “Gatekeepers”) to intermeditate certain communications between a member’s Research Department and companies that are the subject of a research report. Specifically, the SRO Rules¹⁵ provide:

- ▶ That a member **may not submit a research report to the subject company prior to publication**, except for the **review of sections of a draft** of the research report solely to verify facts. Members may not, under any circumstances, provide the subject company sections of research reports that include the research summary, the research rating or the price target.
- ▶ Prior to **submitting any sections of the research report to the subject company**, the Research Department must provide a complete draft of the research report to the Legal or Compliance Department.
- ▶ If after submission to the subject company, the Research Department intends to change the proposed rating or price target, **the Research Department must provide written justification to, and receive prior written authorization from, the Legal or Compliance Department for any change**. The Legal or Compliance Department must retain copies of any drafts and changes thereto of the research reports provided to the subject company.

The SRO Rules prohibit the submission of a research report, in its entirety, to the subject company prior to its publication, even if the research summary, research rating or price target has been redacted from the report. Providing a report with such information redacted could still enable a subject company to discern the tenor of the report and possibly the company’s rating or even price target. The rules only permit submission of sections of a report to verify facts in that section. Submission of facts interspersed with opinions, estimates, conclusions and other non-factually based information by the research analyst violates the SRO Rules. Members should consider submitting to the subject company a separate document containing a summary of facts for which the member seeks verification.

The SROs also wish to clarify the role of the Gatekeepers for purposes of these Rules. Gatekeepers may not merely rubberstamp changes in research reports after sections of the report have been submitted to the subject company. Gatekeepers must review the report and changes thereto, and document the basis for approval. In instances where a change in a rating or price target is to be made, the Gatekeepers must review the written justification provided by

the research department, compare it with any comments received from the subject company regarding sections of the draft that had been submitted for factual verification, and conduct such follow-up inquiry as is necessary to establish a reasonable and causal basis for the change.

Restrictions on Publishing Research

Quiet Periods and Blackout Periods

The SRO Rules impose “quiet periods” during which a member may not publish a research report or make a public appearance regarding a subject company for which the member acted as manager or co-manager of a public offering of securities. The SRO Rules impose on managers and co-managers a 40 calendar-day quiet period following an initial public offering (“IPO”), and a 10 calendar-day quiet period (subject to certain exceptions) following a secondary offering.¹⁶ The SRO Rules also impose a 25 calendar-day quiet period on members that have agreed to participate as an underwriter or dealer (other than as a manager or co-manager) of an issuer’s IPO.¹⁷

The SRO Rules also prohibit a member that has acted as manager or co-manager of a securities offering from publishing a research report or making a public appearance concerning a subject company 15 days prior to or after the expiration, waiver or termination of a “lock-up” or similar agreement that restricts the sale of securities after the completion of a securities offering.¹⁸ Finally, the SRO Rules impose a “blackout period” that prohibits a research analyst from purchasing or selling the securities of a company that the analyst follows for a period beginning 30 days before and ending 5 days after the publication of a research report on the subject company or a change in a rating or price target of the company’s securities.¹⁹

Exceptions to the Quiet Periods and Blackout Periods

The SRO Rules allow a member to publish a research report or make a public appearance during the restricted periods concerning the effects of significant news or a significant event that occurs during those periods, provided that the member’s legal and compliance department authorizes publication of the report before it is issued or the public appearance before it is made.²⁰ Members have asked for additional guidance regarding this exception.

The significant news or event exception is intended to allow for coverage in research reports and public appearances of news or events that have a material impact on, or cause a material change to, a company’s operations, earnings or financial condition, and that generally would

trigger the filing requirements of SEC Form 8-K. Examples might include the rejection of a patent or drug application; a labor strike; resignation of a chief executive officer or chief financial officer; or a publicly-announced investigation into company activities by a regulator. Members have asked whether a subject company's announcement that it exceeded, met or fell short of expected earnings would constitute significant news permitting an exception to the quiet and blackout periods. As a general matter, the SROs would not regard an announcement about earnings to fall within the exception because an earnings announcement itself generally is not a causal event or news item that materially affects a company's operations, earnings or financial condition. There may be cases, however, where significant news or a significant event has caused the company to exceed or fall short of expected earnings that may permit an exception and allow a member to issue a research report within the quiet or blackout period to the extent that it discusses the news item that affected earnings.

Additionally, members have inquired whether the SRO Rules are intended to limit the content of a research report that is issued during a quiet or blackout period due to a significant event or news item to the effects of the event or news, or whether such a report may discuss any other issues related to the subject company. A research report issued pursuant to this exception must be limited to discussing the effects of the news or event that triggered the exception. However, the report may contain or update a price target, rating or recommendation concerning the subject company's securities.

Members also have inquired whether the private placement of a subject company's equity would be a significant event that would allow an exception from the SRO Rules' quiet period provisions. In general, the SROs would not regard the issuance of such securities as a significant event allowing a member to publish research during a quiet period. The private placement of securities is within the issuer's control, and thus not the sort of unforeseen news or event that the SRO Rules contemplated in allowing an exception to the quiet periods.

Application of Quiet Periods to Unregistered Offerings

Members further have asked whether the rules imposing quiet periods following secondary offerings and before and after waivers of lock-up agreements apply to non-registered securities offerings. In general, the quiet period following a secondary offering and before and after the waiver of a lock-up agreement applies only to offerings of securities that must be registered for offer or sale in the United States. Thus, quiet periods would not apply to private placements of Rule 144A securities and Regulation S offerings.

Lock-up Agreements and Waivers

Finally, members have inquired as to what date a lock-up agreement is considered waived for purposes of applying the 15-day quiet period before and after the waiver of a lock-up agreement. The 15-day quiet period is triggered based on the first date a shareholder that is subject to a lock-up agreement may sell his or her shares pursuant to the waiver. It is *not* triggered based on the date when an underwriter or other party notifies shareholders that a waiver has been granted. It is also not triggered based on the date when an underwriter or other party registers a securities offering under the federal securities laws.

Since SRO rules do not require lock-up agreements, and since parties to such agreements often are outside the jurisdiction of the NASD or NYSE, the SROs typically cannot determine whether a specific act or contractual provision in a lock-up agreement constitutes a waiver for the purposes of the SRO quiet periods. However, the SROs remind members that the purpose of the quiet period is to prevent members from publishing favorable research that is intended to drive up the price of an issuer's stock for the benefit of certain shareholders who will no longer be subject to a lock-up agreement. Accordingly, the SROs will closely examine research that is issued or otherwise distributed around the time that an underwriting client of the member sells, or first becomes eligible to sell, a significant volume of the subject company's shares.

Personal Trading Restrictions

Members have raised a number of issues with regard to the application of the personal trading restrictions under the SRO Rules.²¹

Trading Against Recommendations

The SRO Rules generally prohibit a research analyst account²² from purchasing or selling any security or option on or derivative of such security in a manner inconsistent with the research analyst's recommendation as reflected in the most recent research report published by the member.²³ Members have inquired as to whether this restriction applies only to recommendations regarding securities of the subject companies covered by the research analyst making the trade, or whether this restriction applies to the recommendations regarding all subject companies covered by the member. This restriction only applies to trades in securities of subject companies covered by the particular research analyst.

Dividend Reinvestment Programs

Members have inquired whether the SROs regard purchases of securities through a dividend reinvestment plan (“DRIP”) to be subject to the “blackout periods” on personal trading. The SRO Rules generally prohibit a research analyst account from purchasing or selling any security issued by a company that the research analyst follows, or any option on or derivative of such security, for a period beginning 30 calendar days before and ending 5 calendar days after the publication of a research report concerning the company or a rating or price target of the company’s securities.

DRIPs typically are plans that allow a participant to reinvest dividends paid on securities held by the participant in the same class of securities of the issuer. Most DRIPs have two components. First, they automatically reinvest cash dividends in the purchase of additional shares of the same securities held by the participant. Second, they permit periodic discretionary cash investments in the same securities. The SROs would not regard automatic reinvestments of dividends in securities of a subject company as covered by the personal trading restrictions’ blackout periods. The SROs would reach the same conclusion with respect to automatic reinvestments of dividends in investment funds that are subject to the personal trading restrictions.²⁴ However, any discretionary cash investments in a subject company’s securities, or securities of an investment fund that is subject to the personal trading restrictions, that are made through a DRIP would be subject to the blackout periods.

Short Sales

Where a research analyst has a “sell” (or similar) rating on a subject company’s securities, establishes a short position with regard to the securities and later covers the short position, the SROs would regard the covering of the short position as trading contrary to his or her recommendation, since as part of that transaction the analyst would have to buy the securities. Moreover, an analyst may not establish a short position on a rated security during an applicable blackout period.

Trades During “Neutral” Ratings

Some members have inquired whether a research analyst may buy or sell a subject company’s securities if the analyst has assigned a “neutral” or “market perform” (or similar) rating to such securities. The SROs regard these (or similar) ratings as the same as a “hold” rating. Accordingly, a research analyst may neither buy nor sell a subject company’s securities to which he or she has assigned a hold (or similar) rating.

Changes in Earnings Estimates

Several members have inquired whether the personal trading blackout period would be triggered if a research analyst changed his or her earnings estimates for a subject company, assuming that the change did not coincide with the issuance of a new research report and did not result in a change in the rating or price target for the subject company's securities. These circumstances would not trigger the personal trading blackout period.

Trading Restrictions on Supervisors of Research Analysts

The SRO Rules now require a member's legal or compliance personnel to pre-approve all transactions of persons who oversee research analysts to the extent such transactions involve equity securities of subject companies covered by the research analysts that they oversee.²⁵ The SRO Rules also have been amended to make clear that the research analyst personal trading restrictions do not apply to "blind trusts" that are controlled by a person other than the research analyst or a member of the analyst's household where neither the analyst nor a household member knows of the account's investments or transactions.²⁶ Likewise, the requirements for legal or compliance personnel to pre-approve securities transactions of supervisory personnel do not apply to transactions within "blind trusts" of which supervisory personnel are the beneficiaries.

The SROs have been asked how the requirement that legal or compliance personnel pre-approve the trades of supervisory personnel applies to an account that is managed by a third party (either an outside manager or an in-house account). As a general matter, the SROs would consider a member to have met its obligations to pre-approve a supervisor's transactions in a managed account where the supervisor has no discretion or control if the member has policies and procedures to monitor the managed account's trades. If such policies and procedures are in place, the SROs would not require legal or compliance personnel to pre-approve each transaction made within the managed account.

Disclosure Issues

In reviewing members' research reports, the SROs have found that some reports fail adequately to make the disclosures required by the SRO Rules.²⁷ This section of the joint memorandum is intended to highlight some of the more common problems that the SROs have found.

Prominence of Disclosures

The first page of a research report must include the disclosures required under the SRO Rules or must refer the reader to the pages on which such disclosures are found. Disclosures, and references to disclosures, must be clear, comprehensive and prominent.²⁸

References on the front page of a research report to where disclosures are located must be separated from the report's body text, and in larger font size than the body text. For example, many firms are enclosing the references to disclosure location in a box on the first page of the report that enhances the prominence of the disclosure reference.

A notation on the first page that refers readers to the "end of the report" rather than the specific page is not sufficient. The SRO Rules require a reference to the specific page number or to the last page of the report or to a specific section of the report, such as the appendix. In addition, members may use hyperlinks to direct the reader to the required disclosures only in electronically transmitted reports and compendium reports²⁹ or as an additional point of reference in written reports.

Regardless of where the required disclosures are placed, they should be labeled using a heading such as "Important Disclosures" or "Required Disclosures" so as to be clearly identifiable. Similarly, the font size of the type must be large enough so that the disclosures are clearly legible and distinguishable from body text, other disclosures or disclaimers

The "Important (or Required) Disclosures" section must include all applicable required textual disclosures (e.g., market making, ownership positions, compensation, etc.), the price chart, the ratings description, ratings distribution (by number of investment banking clients), the valuation methodology, price target and related risk factors description, in a clear and logical order. As an example, related disclosures such as ratings systems and ratings distributions should be in close proximity.

Disclosure of Officer or Director Positions

A member is required to disclose in research reports if the research analyst or member of his or her household is an officer, director, or advisory board member of the recommended issuer.³⁰ This disclosure, if applicable, must include the position held by the research analyst or household member.

Conditional or Indefinite Language

Members are required to disclose in research reports if they own 1% or more of a subject company's equity securities and if they make a market in a subject company's securities at the time the research report is issued. Members also must disclose if the member or its affiliates: (a) managed or co-managed a public offering of equity securities for the subject company in the past twelve months; (b) received compensation for investment banking services from the subject company in the past twelve months; or (c) expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.³¹

Members may not use conditional or indefinite language in required disclosures, such as "may have a position" or "may make a market" in any of the subject company's securities, or that the reader "should assume" that the firm or its affiliates engaged in investment banking business with a subject company. The required disclosures with respect to past receipt and expectation of investment banking services related compensation must be made separately, if applicable. For example, a member may not disclose that it "received compensation for investment banking services in the past twelve months or expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months." Such disclosure lacks the specificity required by the SRO Rules.

Use of Disclaimers

Research reports may not include general or specific disclaimers that contradict or are inconsistent with disclosures required by SRO Rules. For example, it is inconsistent for a research report to disclose that the member makes a market in the specific securities that are the subject of the research report and separately to disclose generally that the member may make a market in some or all of the securities mentioned in the report.

The presence of disclosures and disclaimers not required by the SRO Rules in close proximity to the disclosures required by the SRO Rules may cause confusion and detract from their readability. Therefore, any disclosures or disclaimers not required by the SRO Rules must be clearly separated and appropriately labeled. If the required disclosures are placed near non-required disclaimers and disclosures, each set of disclosures and disclaimers must be clearly labeled, e.g., "Important (or Required) Disclosures," "Other Disclosures," and "Disclaimers." The disclosures required by the SRO Rules also must be separate from disclosures required by foreign jurisdictions.

Use of Stock Symbols

Members may not use stock symbols in the "Important Disclosures" section of the report unless the reader is specifically directed to where in the report the subject companies represented by the symbols are identified by proper names.

Disclosure of Ratings Distributions and Price Charts

The SRO Rules allow members to use any ratings system they deem appropriate in their research reports, so long as they are accompanied by a clear definition of the meaning of each rating used in the system.³² The SRO Rules require a member to disclose in each research report the percentages of all securities rated by the member to which the member has assigned a "buy", "hold/neutral" or "sell" rating.³³ The SRO Rules also require each report to disclose the percentage of subject companies within each of these three rating categories for whom the member has provided investment banking services within the previous 12 months.³⁴

If a member utilizes a ratings system that employs terms different than "buy," "hold/neutral" and "sell," the member must determine, based on its own ratings system, into which of these three categories its ratings fall. The research report must use the terms "buy," "hold" and "sell" in making these ratings distributions disclosures. However, if a member uses a ratings system that employs terms other than "buy," "hold/neutral" and "sell," the member may combine its own ratings terms with those categories required by the SRO Rules to make the ratings distribution disclosures (e.g., "buy/overweight," "hold/equalweight" and "sell/underweight").

The SRO Rules specify that information regarding ratings distributions must be current as of the most recent calendar quarter end (or the second most recent calendar quarter end if the publication date is less than 15 days after the most recent calendar quarter).³⁵ The SRO Rules do not specify, however, what time period the ratings distribution must cover. Some members have noted that they do not regularly issue ratings and thus were uncertain as to how far back the ratings distribution universe must extend. In general, the ratings distribution should include all current ratings of the member. However, if the member does not issue new ratings on a relatively frequent basis, the SROs will consider a member to have complied with the ratings distribution disclosure requirements if the distribution includes ratings that the member has issued within the past 12 months.

If a research report does not contain any rating – express or implied – of the subject company’s stock, the report is not required to include the ratings distribution information required by the SRO Rules. In addition, if the report does not include either a rating or a price target for the subject company’s stock, the report is not required to include a price chart.³⁶

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- 1 See *NASD Notice to Members 02-39* (July 2002) and NYSE Information Memo No. 02-26 (June 26, 2002), both of which included a Joint Memorandum.
 - 2 See SEC Release No. 34-45908 (May 10, 2000), 67 Fed. Reg. 34968 (May 16, 2002).
 - 3 For purposes of the NYSE Rules, the term “member” as used in this Joint Memorandum refers to both members and member organizations of the NYSE.
 - 4 See SEC Release No. 34-48252 (July 29, 2003), 68 Fed. Reg. 45875 (Aug. 4, 2003).
 - 5 NASD Rules 1050 and 1120 and NYSE Rules 344 and 345A.
 - 6 NASD Rule 2711(a)(8) and NYSE Rule 472.10(2).
 - 7 See SEC Release Nos. 33-8193, 34-47384 (Feb. 20, 2003), 68 Fed. Reg. 9481, 9485 (Feb. 27, 2003).
 - 8 NASD Rule 2711(a)(4) and NYSE Rule 472.50.
 - 9 See SEC Release Nos. 33-8193, 34-47384 (Feb. 20, 2003), 68 Fed. Reg. 9481, 9485 (Feb. 27, 2003).
 - 10 NASD Rule 2711(h)(1)(B) and NYSE Rule 472(k)(1)(i)c.
 - 11 NASD Rule 2711(h)(2)(A)(ii) and NYSE Rule 472(k)(1)(i)a.
 - 12 NASD Rule 2711(h)(8) and NYSE Rule 472(k)(1)(i)b.
 - 13 NASD Rule 2711(h)(1)(C) and NYSE Rule 472(k)(1)(iii)d.
 - 14 A “globally-branded” research report refers to the use of a single marketing identity that encompasses the member and its affiliates.
 - 15 NASD Rule 2711(c) and NYSE Rule 472(b)(4).
 - 16 NASD Rule 2711(f)(1) and NYSE Rule 472(f)(1) and (2).
 - 17 NASD Rule 2711(f)(2) and NYSE Rule 472(f)(3).
 - 18 NASD Rule 2711(f)(4) and NYSE Rule 472(f)(4).
 - 19 NASD Rule 2711(g)(2) and NYSE Rule 472(e)(2).
 - 20 NASD Rules 2711(f)(1)(B)(i), 2711(f)(4) and 2711(g)(2)(B), and NYSE Rules 472(e)(4)(ii) and 472(f)(5).
 - 21 NASD Rule 2711(g) and NYSE Rule 472(e).
 - 22 A “research analyst account” includes any account in which a research analyst or member of the research analyst’s household has a financial interest, or over which the analyst has discretion or control, other than an investment company registered under the Investment Company Act of 1940. NASD Rule 2711(a)(6). See *also* NYSE Rule 472.40.
 - 23 NASD Rule 2711(g)(3) and NYSE Rule 472(e)(3).
 - 24 The SRO Rules exclude from the personal trading restrictions investments in registered diversified investment companies and other investment funds that meet certain criteria. See NASD Rule 2711(g)(5) and NYSE Rule 472(e)(4)(v) and (vi).
 - 25 NASD Rule 2711(g)(6) and NYSE Rule 472(e)(5).
 - 26 NASD Rule 2711(a)(6) and NYSE Rule 472.40.
 - 27 See NASD Rule 2711(h) and NYSE Rule 472(k)(1).
 - 28 NASD Rule 2711(h)(10) and NYSE Rule 472(k)(1).
 - 29 A “compendium report” is a research report that covers six or more subject companies. See NASD Rule 2711(h)(11) and NYSE Rule 472(k)(1).
 - 30 NASD Rule 2711(h)(3) and NYSE Rule 472(k)(1)(iii)c.
 - 31 NASD Rules 2711(h)(1)(B), (h)(2)(A)(ii), and (h)(8); NYSE Rules 472(k)(1)(i)a., b., and c.
 - 32 NASD Rule 2711(h)(4) and NYSE Rules 472(k)(1)(i)f.
 - 33 NASD Rule 2711(h)(5)(A) and NYSE Rule 472(k)(1)(i)g. and 472.70.
 - 34 NASD Rule 2711(h)(5)(B) and NYSE Rule 472(k)(1)(i)g. and 472.70.
 - 35 NASD Rule 2711(h)(5)(C) and NYSE Rule 472.70.
 - 36 See NASD Rule 2711(h)(6) and NYSE Rule 472(k)(1)(i)h.

ATTACHMENT B

2711. Research Analysts and Research Reports

(a) Definitions

For purposes of this rule, the following terms shall be defined as provided.

(1) "Investment banking department" means any department or division, whether or not identified as such, that performs any investment banking service on behalf of a member.

(2) "Investment banking services" include, without limitation, acting as an underwriter in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPEs or similar investments; or serving as placement agent for the issuer.

(3) "Member of a research analyst's household" means any individual whose principal residence is the same as the research analyst's principal residence.

(4) "Public appearance" means any participation in a seminar, forum (including an interactive electronic forum), radio, television or print media interview, or other public speaking activity, or the writing of a print media article, in which a research analyst makes a recommendation or offers an opinion concerning an equity security.

(5) "Research analyst" means the associated person who is primarily responsible for, and any associated person who reports directly or indirectly to such a research analyst in connection with, preparation of the substance of a research report, whether or not any such person has the job title of "research analyst."

(6) "Research analyst account" means any account in which a research analyst or member of the research analyst's household has a financial interest, or over which such analyst has discretion or control, other than an investment company registered under the Investment Company Act of 1940. This term does not include a "blind trust" account that is controlled by a person other than the research analyst or member of the research analyst's household where neither the research analyst nor a member of the research analyst's household knows of the account's investments or investment transactions.

(7) "Research department" means any department or division, whether or not identified as such, that is principally responsible for preparing the substance of a research report on behalf of a member.

(8) "Research Report" means a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.

(9) "Subject company" means the company whose equity securities are the subject of a research report or a public appearance.

(b) Restrictions on Relationships with Research Department

(1) No research analyst may be subject to the supervision or control of any employee of the member's investment banking department, and no personnel engaged in investment banking activities may have any influence or control over the compensatory evaluation of a research analyst.

(2) Except as provided in paragraph (b)(3), no employee of the investment banking department or any other employee of the member who is not directly responsible for investment research ("non-research personnel"), other than legal or compliance personnel, may review or approve a research report of the member before its publication.

(3) Non-research personnel may review a research report before its publication as necessary only to verify the factual accuracy of information in the research report or identify any potential conflict of interest, provided that:

(A) any written communication between non-research personnel and research department personnel concerning the content of a research report must be made either through authorized legal or compliance personnel of the member or in a transmission copied to such personnel; and

(B) any oral communication between non-research personnel and research department personnel concerning the content of a research report must be documented and made either through authorized legal or compliance personnel acting as intermediary or in a conversation conducted in the presence of such personnel.

(c) Restrictions on Communications with the Subject Company

(1) Except as provided in paragraphs (c)(2) and (c)(3), a member may not submit a research report to the subject company before its publication.

(2) A member may submit sections of such a research report to the subject company before its publication for review as necessary only to verify the factual accuracy of information in those sections, provided that:

(A) the sections of the research report submitted to the subject company do not contain the research summary, the research rating or the price target;

(B) a complete draft of the research report is provided to legal or compliance personnel before sections of the report are submitted to the subject company; and

(C) if after submitting the sections of the research report to the subject company the research department intends to change the proposed rating or price target, it must first provide written justification to, and receive written authorization from, legal or compliance personnel for the change. The member must retain copies of any draft and the final version of such a research report for three years following its publication.

(3) The member may notify a subject company that the member intends to change its rating of the subject company's securities, provided that the notification occurs on the business day before the member announces the rating change, after the close of trading in the principal market of the subject company's securities.

(4) No research analyst may participate in efforts to solicit investment banking business. Accordingly, no research analyst may, among other things, participate in any "pitches" for investment banking business to prospective investment banking clients, or have other communications with companies for the purpose of soliciting investment banking business.

(d) Restrictions on Research Analyst Compensation

(1) No member may pay any bonus, salary or other form of compensation to a research analyst that is based upon a specific investment banking services transaction.

(2) The compensation of a research analyst who is primarily responsible for the preparation of the substance of a research report must be reviewed and approved at least annually by a committee that reports to the member's board of directors, or when the member has no board of directors, to a senior executive officer of the member. This committee may not have representation from the member's investment banking department. The committee must consider the following factors when reviewing such a research analyst's compensation, if applicable:

(A) the research analyst's individual performance, including the analyst's productivity and the quality of the analyst's research;

(B) the correlation between the research analyst's recommendations and the stock price performance; and

(C) the overall ratings received from clients, sales force, and peers independent of the member's investment banking department, and other independent ratings services.

The committee may not consider as a factor in reviewing and approving such a research analyst's compensation his or her contributions to the member's investment banking business. The committee must document the basis upon which each such research analyst's compensation was established. The annual attestation required by Rule 2711(i) must certify that the committee reviewed and approved each such research analyst's compensation and documented the basis upon which this compensation was established.

(e) Prohibition of Promise of Favorable Research

No member may directly or indirectly offer favorable research, a specific rating or a specific price target, or threaten to change research, a rating or a price target, to a company as consideration or inducement for the receipt of business or compensation.

**(f) Restrictions on Publishing Research Reports and Public Appearances;
Termination of Coverage**

(1) No member may publish or otherwise distribute a research report and no research analyst may make a public appearance regarding a subject company for which the member acted as manager or co-manager of:

(A) an initial public offering, for 40 calendar days following the date of the offering; or

(B) a secondary offering, for 10 calendar days following the date of the offering; provided that:

(i) paragraphs (f)(1)(A) and (f)(1)(B) will not prevent a member from publishing or otherwise distributing a research report, or prevent a research analyst from making a public appearance, concerning the effects of significant news or a significant event on the subject company within such 40- and 10-day periods, and provided further that legal or compliance personnel authorize publication of that research report before it is issued or authorize the public appearance before it is made; and

(ii) paragraph (f)(1)(B) will not prevent a member from publishing or otherwise distributing a research report pursuant to SEC Rule 139 regarding a subject company with "actively-traded securities," as defined in Regulation M, 17 CFR 242.101(c)(1)), and will not prevent a research analyst from making a public appearance concerning such a company.

(2) No member that has agreed to participate or is participating as an underwriter or dealer (other than as manager or co-manager) of an issuer's initial public offering may publish or otherwise distribute a research report or make a public appearance regarding that issuer for 25 calendar days after the date of the offering.

(3) For purposes of paragraphs (f)(1) and (f)(2), the term "date of the offering" refers to the later of the effective date of the registration statement or the first date on which the security was bona fide offered to the public.

(4) No member that has acted as a manager or co-manager of a securities offering may publish or otherwise distribute a research report or make a public appearance concerning a subject company 15 days prior to and after the expiration, waiver or

termination of a lock-up agreement or any other agreement that the member has entered into with a subject company or its shareholders that restricts or prohibits the sale of securities held by the subject company or its shareholders after the completion of a securities offering. This paragraph will not prevent a member from publishing or otherwise distributing a research report concerning the effects of significant news or a significant event on the subject company within such period, provided legal or compliance personnel authorize publication of that research report before it is issued. In addition, this paragraph shall not apply to the publication or distribution of a research report pursuant to SEC Rule 139 regarding a subject company with "actively traded securities," as defined in Regulation M, 17 CFR 242.101(c)(1), or to a public appearance concerning such a subject company.

(5) If a member intends to terminate its research coverage of a subject company, notice of this termination must be made. The member must make available a final research report on the subject company using the means of dissemination equivalent to those it ordinarily uses to provide the customer with its research reports on the subject company. The report must be comparable in scope and detail to prior research reports and must include a final recommendation or rating, unless it is impracticable for the member to produce a comparable report (e.g., if the research analyst covering the subject company or sector has left the member or if the member terminates coverage of the industry or sector). If it is impracticable to produce a final recommendation or rating, the final research report must disclose the member's rationale for the decision to terminate coverage.

(g) Restrictions on Personal Trading by Research Analysts

(1) No research analyst account may purchase or receive any securities before the issuer's initial public offering if the issuer is principally engaged in the same types of business as companies that the research analyst follows.

(2) No research analyst account may purchase or sell any security issued by a company that the research analyst follows, or any option on or derivative of such security, for a period beginning 30 calendar days before and ending five calendar days after the publication of a research report concerning the company or a change in a rating or price target of the company's securities; provided that:

(A) a member may permit a research analyst account to sell securities held by the account that are issued by a company that the research analyst follows, within 30 calendar days after the research analyst began following the company for the member;

(B) a member may permit a research analyst account to purchase or sell any security issued by a subject company within 30 calendar days before the publication of a research report or change in the rating or price target of the subject company's securities due to significant news or a significant event concerning the subject company, provided that legal or compliance personnel pre-approve the research report and any change in the rating or price target.

(3) No research analyst account may purchase or sell any security or any option on or derivative of such security in a manner inconsistent with the research analyst's recommendation as reflected in the most recent research report published by the member.

(4) Legal or compliance personnel may authorize a transaction otherwise prohibited by paragraphs (g)(2) and (g)(3) based upon an unanticipated significant change in the personal financial circumstances of the beneficial owner of the research analyst account, provided that:

(A) legal or compliance personnel authorize the transaction before it is entered;

(B) each exception is granted in compliance with policies and procedures adopted by the member that are reasonably designed to ensure that these transactions do not create a conflict of interest between the professional responsibilities of the research analyst and the personal trading activities of a research analyst account; and

(C) the member maintains written records concerning each transaction and the justification for permitting the transaction for three years following the date on which the transaction is approved.

(5) The prohibitions in paragraphs (g)(1) through (g)(3) do not apply to a purchase or sale of the securities of:

(A) any registered diversified investment company as defined under Section (5)(b)(1) of the Investment Company Act of 1940; or

(B) any other investment fund over which neither the research analyst nor a member of the research analyst's household has any investment discretion or control, provided that:

(i) the research analyst accounts collectively own interests representing no more than 1% of the assets of the fund;

(ii) the fund invests no more than 20% of its assets in securities of issuers principally engaged in the same types of business as companies that the research analyst follows; and

(iii) if the investment fund distributes securities in kind to the research analyst or household member before the issuer's initial public offering, the research analyst or household member must either divest those securities immediately or the research analyst must refrain from participating in the preparation of research reports concerning that issuer.

(6) Legal or compliance personnel of the member shall pre-approve all transactions of persons who oversee research analysts to the extent such transactions involve equity securities of subject companies covered by the research analysts that they oversee. This pre-approval requirement shall apply to all persons, such as the director of research, supervisory analyst, or member of a committee, who have direct influence or control with respect to the preparation of the substance of research reports or establishing or changing a rating or price target of a subject company's equity securities.

(h) Disclosure Requirements

(1) Ownership and Material Conflicts of Interest

A member must disclose in research reports and a research analyst must disclose in public appearances:

(A) if the research analyst or a member of the research analyst's household has a financial interest in the securities of the subject company, and the nature of the financial interest (including, without limitation, whether it consists of any option, right, warrant, future, long or short position);

(B) if, as of the end of the month immediately preceding the date of publication of the research report or the public appearance (or the end of the second most recent month if the publication date is less than 10 calendar days after the end of the most recent month), the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. Computation of beneficial ownership of securities must be based upon the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Securities Exchange Act of 1934; and

(C) any other actual, material conflict of interest of the research analyst of which the research analyst or member knows or has reason to know at the time of publication of the research report, or at the time of the public appearance.

(2) Receipt of Compensation

(A) A member must disclose in research reports:

(i) if the research analyst received compensation:

a. based upon (among other factors) the member's investment banking services revenues; or

b. from the subject company in the past 12 months.

(ii) if the member or any affiliate:

a. managed or co-managed a public offering of securities for the subject company in the past 12 months;

b. received compensation for investment banking services from the subject company in the past 12 months; or

c. expects to receive or intends to seek compensation for investment banking services from the subject company in the next 3 months.

(iii) if (1) as of the end of the month immediately preceding the date of publication of the research report (or the end of the second most recent month if the publication date is less than 30 calendar days after the end of the most recent month) or (2) to the extent the research analyst or an employee of the member with the ability to influence the substance of the research knows:

a. the member received any compensation for products or services other than investment banking services from the subject company in the past 12 months; or

b. the subject company currently is, or during the 12-month period preceding the date of distribution of the research report was, a client of the member. In such cases, the member also must disclose the types of services provided to the subject company. For purposes of this Rule 2711(h)(2), the types of services provided to the subject company shall be described as investment banking services, non-investment banking securities-related services, and non-securities services.

(iv) if, to the extent the research analyst or an employee of the member with the ability to influence the substance of the research report knows an affiliate of the member received any compensation for products or services other than investment banking services from the subject company in the past 12 months.

(v) if, to the extent the research analyst or member has reason to know, an affiliate of the member received any compensation for products or services other than investment banking services from the subject company in the past 12 months.

a. This requirement will be deemed satisfied if such compensation is disclosed in research reports within 30 days after completion of the last calendar quarter, provided that the member has taken steps reasonably designed to identify any such compensation during that calendar quarter. This requirement shall not apply to any subject company as to which the member initiated coverage since the beginning of the current calendar quarter.

b. The research analyst and the member will be presumed not to have reason to know whether an affiliate received any compensation for products or services other than investment banking services from the subject company in the past 12 months if the member maintains and enforces policies and procedures reasonably designed to prevent the research analysts and employees of the member with the ability to

influence the substance of research reports from, directly or indirectly, receiving information from the affiliate concerning whether the affiliate received such compensation.

(vi) For the purposes of this Rule 2711(h)(2), an employee of the member with the ability to influence the substance of the research report is an employee who, in the ordinary course of that person's duties, has the authority to review the particular research report and to change that research report prior to publication.

(B) A research analyst must disclose in public appearances:

(i) if, to the extent the research analyst knows or has reason to know, the member or any affiliate received any compensation from the subject company in the past 12 months;

(ii) if the research analyst received any compensation from the subject company in the past 12 months; or

(iii) if, to the extent the research analyst knows or has reason to know, the subject company currently is, or during the 12-month period preceding the date of distribution of the research report, was, a client of the member. In such cases, the research analyst also must disclose the types of services provided to the subject company, if known by the research analyst.

(C) A member or research analyst will not be required to make a disclosure required by paragraphs (h)(2)(A)(ii)(b) and (c), (h)(2)(A)(iii)(b), or (h)(2)(B)(i) and (iii) to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.

(3) Position as Officer or Director

A member must disclose in research reports and a research analyst must disclose in public appearances if the research analyst or a member of the research analyst's household serves as an officer, director or advisory board member of the subject company.

(4) Meaning of Ratings

A member must define in its research reports the meaning of each rating used by the member in its rating system. The definition of each rating must be consistent with its plain meaning.

(5) Distribution of Ratings

(A) Regardless of the rating system that a member employs, a member must disclose in each research report the percentage of all securities rated by the member to which the member would assign a “buy,” “hold/neutral,” or “sell” rating.

(B) In each research report, the member must disclose the percentage of subject companies within each of these three categories for whom the member has provided investment banking services within the previous twelve months.

(C) The information that is disclosed under paragraphs (h)(5)(A) and (h)(5)(B) must be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date is less than 15 calendar days after the most recent calendar quarter).

(6) Price Chart

A member must present in any research report concerning an equity security on which the member has assigned any rating for at least one year, a line graph of the security's daily closing prices for the period that the member has assigned any rating or for a three-year period, whichever is shorter. The line graph must:

(A) indicate the dates on which the member assigned or changed each rating or price target;

(B) depict each rating and price target assigned or changed on those dates; and

(C) be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date is less than 15 calendar days after the most recent calendar quarter).

(7) Price Targets

A member must disclose in research reports the valuation methods used to determine a price target. Price targets must have a reasonable basis and must be accompanied by a disclosure concerning the risks that may impede achievement of the price target.

(8) Market Making

A member must disclose in research reports if it was making a market in the subject company's securities at the time that the research report was published.

(9) Disclosure Required by Other Provisions

In addition to the disclosure required by this rule, members and research analysts must provide disclosure in research reports and public appearances that is required by applicable law or regulation, including NASD Rule 2210 and the antifraud provisions of the federal securities laws.

(10) Prominence of Disclosure

The disclosures required by this paragraph (h) must be presented on the front page of research reports or the front page must refer to the page on which disclosures are found. Disclosures and references to disclosures must be clear, comprehensive and prominent.

(11) Disclosures in Research Reports Covering Six or More Companies

When a member distributes a research report covering six or more subject companies, for purposes of the disclosures required in paragraph (h), such research report may direct the reader in a clear manner as to where they may obtain applicable current disclosures in written or electronic format.

(12) Records of Public Appearances

Members must maintain records of public appearances by research analysts sufficient to demonstrate compliance by those research analysts with the applicable disclosure requirements under paragraph (h) of this Rule. Such records must be maintained for three years from the date of the public appearance.

(i) Supervisory Procedures

Each member subject to this rule must adopt and implement written supervisory procedures reasonably designed to ensure that the member and its employees comply with the provisions of this rule (including the attestation requirements of Rule 2711(d)(2)), and a senior officer of such a member must attest annually to NASD by April 1 of each year that it has adopted and implemented those procedures.

(j) Prohibition of Retaliation Against Research Analysts

No member and no employee of a member who is involved with the member's investment banking activities may, directly or indirectly, retaliate against or threaten to retaliate against any research analyst employed by the member or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report or public appearance written or made by the research analyst that may adversely affect the member's present or prospective investment banking relationship with the subject company of a research report. This prohibition shall not limit a member's authority to discipline or terminate a research analyst, in accordance with the member's policies and procedures, for any cause other than the writing of such an unfavorable research report or the making of such an unfavorable public appearance.

(k) Exceptions for Small Firms

The provisions of paragraph (b) shall not apply to members that over the previous three years, on average per year, have participated in 10 or fewer investment banking services transactions as manager or co-manager and generated \$5 million or less in gross investment banking services revenues from those transactions. For purposes of this paragraph (k), the term "investment banking services transactions" includes the underwriting of both corporate debt and equity securities but not municipal securities. Members that qualify for this exemption must maintain records for three years of any communication that, but for this exemption, would be subject to paragraph (b) of this Rule.